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RUEHNE/AMEMBASSY NEW DELHI 1236
RUEHKA/AMEMBASSY DHAKA 0320
RUEHIL/AMEMBASSY ISLAMABAD 7303
RUEHKT/AMEMBASSY KATHMANDU 5417
RUEHKP/AMCONSUL KARACHI 2221
RUEHCG/AMCONSUL CHENNAI 7895
RUCPDOG/DEPT OF COMMERCE WASHDC
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SUBJECT: SRI LANKA: CENTRAL BANK GOVERNOR SAYS ECONOMY IS BETTER
THAN EVERYONE THINKS

¶1. (SBU) SUMMARY: In a recent presentation trumpeting the health of the Sri Lankan economy, Central Bank governor Cabraal told heads of missions and donor agencies that return to civil war was not ruining growth or busting the government's budget. The governor predicted that GDP growth would exceed last year's strong 7.4% showing, and that inflation would come down to single digits by the end of the year. The governor ran through a series of "perceptions/claims" and realities -- the former, he said, perpetuated by terrorists, political opponents, and an overly critical media and the latter justified by actual statistics.

¶2. (SBU) COMMENT: While the nearly two-hour presentation was generally accurate, its tone sounded more like marketing spin than Central Bank commentary. Its forecasts assumed fundamentals would continue to resemble the relatively healthy 2002-2006 statistics produced by the ceasefire years. First quarter 2007 numbers don't support these projections, and current negative business sentiment suggests that this year and next could prove far weaker than the government expects. It is this negative business sentiment that the governor would like to turn around, but the business people are reacting to government policies and market trends that are hurting them, not to the governor's slide shows. While the governor is correct that the economy is not on the verge of a crash, he should listen more to his business community than to last year's statistics. End summary and comment.

CENTRAL BANK TELLS DIPLOMATS AND PRESS
THE ECONOMY IS STRONGER THAN IT LOOKS

¶3. (SBU) Sri Lankan Central Bank Governor Nivard Cabraal invited ambassadors and donor agency heads to a July 23 presentation entitled "The Sri Lankan Economy: Perceptions/Claims vs. Realities." The governor, his two deputies, one assistant governor, and Finance Secretary PB Jayasundera each presented slides covering fiscal and

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monetary policy, debt management, banking and finance, infrastructure investment, and donor assistance. The Central Bank organized a similar presentation for the media later in the week.

¶4. (SBU) The one hour forty-five minute presentation was designed to dispel impressions that the economy was suffering badly as a result of renewed fighting against the ethnic separatist Liberation Tigers of Tamil Eelam. After his colleagues described the full range of economic fundamentals in considerable detail, Governor Cabraal presented a wrap-up, which set "perceptions" and "claims" against "realities." He attributed the negative perceptions and claims to four factors: "Lack of awareness; deliberate misinformation and negative publicity campaigns conducted by interested parties, including terrorist groups and sympathizers; promotion of various economic and political agendas; and organized efforts to cripple Sri Lanka's economy and weaken the State's capacity and ability to take counterterrorist measures."

CLAIMS AND REALITIES: TRUTH SOMEWHERE IN BETWEEN

¶5. (SBU) The governor's overarching message was that Sri Lanka's economic growth was resilient and sustainable, and that the economy had in fact performed well in the face of a series of economic shocks, including the 2004 tsunami, the worsening security situation, high oil prices, and unfavorable weather. The following are a sampling of the perceptions and realities the governor outlined, with Embassy comments on each.

- Critics' claim: "The worsening security situation will erode investor confidence and cripple the economy."
- Governor's reality: "Investor sentiment remains strong."
- Governor's evidence: Colombo Stock Exchange rose from 1400 to 2400 between 2004 and 2006; foreign direct investment increased from \$181 million in 2002 to \$480 million in 2006.

(Comment: The stock exchange was doing very well, but has fallen 16% since peaking at 3000 in February 2007. FDI figures are for commitments only, some of which are likely to evaporate as a result of the resumed fighting. A local business journal's monthly survey of business confidence dipped to the lowest it has been since

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October 2004, with four-fifths of business people surveyed saying they expect the economy to get worse in the coming twelve months.)

- Critics' claim: "Rising cost of living will hamper growth and stability."
- Governor's reality: "GDP growth has been very strong despite rising cost of living."
- Governor's evidence: GDP growth was 7.4% in 2006 and will reach 7.5% in 2007.

(Comment: GDP growth slowed to 6.1% in the first quarter of 2007 and is unlikely to exceed that rate for the year.)

- Critics' claim: "Government debt is out of control and an overwhelming portion of the deficit is being financed by the Central Bank."
- Governor's reality: "Debt has declined significantly - 13 percentage points of GDP in three years."
- Governor's evidence: Public debt as a share of GDP declined from around 106% in 2003 to 93% in 2006.

(Comment: 93% is far higher than the comparable figures for the Philippines, about 60%, or Colombia, about 45%. A growing portion of Sri Lanka's debt is at commercial rather than concessionary rates and in foreign currencies, against which the rupee is declining, so servicing the debt is actually getting more expensive.)

- Critics' claim: "Violence will lead to the economy collapsing and defense expenses soaring."
- Governor's reality: "Security situation has not deteriorated materially."
- Governor's evidence: A comparison chart showing 2006 military spending as a percent of GDP for thirteen countries, showing Saudi Arabia at 10%, Pakistan at 4.4%, Sri Lanka at 3.8%, and Indonesia at 3.0%.

(Comment: The Governor's chart cited the CIA World Factbook as its source. But the Central Bank's own figure for 2006 military spending as a percent of GDP is actually 4.0%, and the 2007 budget figure is 4.3%. The actual figure for 2007 is likely to be even higher, after supplemental budgets are included.)

